No. 9985

United States
Circuit Court of Appeals

For the Ninth Circuit

SAN FRANCISCO LAUNDRY ASSOCIATION,
a corporation,

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

PETITION FOR REHEARING

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The appellant hereby petitions for rehearing.

In its opinion of affirmance, this court sums up the grounds of its decision as follows:

"It is plain that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected. Hence the proceeding was not instituted in good faith, sec. 146(3) of the Act, 11 USC 546(3), and the dismissal was proper, sec. 144, 11 USC 544. See Chapman Bros. v. Security-First Nat. Bank of Los Angeles, 9 Cir., 111 F2d86; Case v. Los Angeles Lumber Co., 308 U.S. 106."

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The appellant respectfully represents that Case v. Los Angeles Lumber Co., supra, cited by this court, does not support the foregoing statement, but is in fact contrary thereto.

In that case, the Supreme Court did not order dismissal of the reorganization proceeding; but, although pointing out that the bondholders' lien amounted to $3,800,000, and that assets did not exceed $900,000, and disapproving the proposed plan, expressly stated, 308 U. S. at page 131,

"Failure to accept this plan does not force dismissal or liquidation",

and, 308 U. S. at pages 131 and 132,

"In this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted",

and remanded the case to the district court for further proceedings.

Thus it cannot be doubted that Case v. Los Angeles Lumber Co. is direct authority for the proposition that a debtor though insolvent in the bankruptcy sense, may nevertheless effect reorganization under the Act.

This is also the necessary implication of the provision of sec. 176 of the Act, 11 USC 576, that where a corporation is insolvent, its stockholders shall not vote on the plan.

This is also the view of the 2nd Circuit,

Central Funding, 2 Cir., 75 F. 2d 256,

Castle Beach Apartments, 2 Cir. 113 F. 2d 762,

Marine Harbor Properties, 2 Cir., 125 F. 2d 296

and coincides with appellee's admission on page 22 of its brief.

Hence the premise upon which the present decision is based, "that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected", is untenable. The district court did not find "that there is no reason to expect that a reorganization can be effected", or its equivalent; there is no evidence to sustain such a finding; and in the light of Case v. Los Angeles Lumber Co. it cannot be inferred as a matter of law.

Nor does Chapman Bros. Co. v. Security-First Nat. Bank, supra, also cited by this court in support of its present decision, in fact support it.

In the Chapman Bros. case, the district court found (see Record in that case, pages 88 and 89):

"That no plan of reorganization can be presented that can afford any relief to the debtor corporation"

"That the debtor corporation cannot evolve any plan of reorganization that would be fair and equitable and that would enable it to pay the creditors in full"

"That it is unreasonable for the debtor corporation to expect that any possible plan of reorganization could be effected."

And, as this court recited, 111 F. 2d at p. 87, the district court concluded

"that appellant's petition was not made in good faith; that 'it was unreasonable for the debtor corporation to expect that any plan of reorganization could be effected.' "

In these respects the Chapman Bros. case is different from the present, for here there are no findings of fact or conclusions of law comparable to any of the foregoing. Indeed, herein the district court in its findings and decree was silent respecting such matters.

Moreover, in the Chapman Bros. case, the district court found (Record, page 88):

"That there is no possibility of debtor corporation securing any new working capital."

Here, on the contrary, the plan discloses that such capital has in fact been secured.

Furthermore, in the Chapman Bros. case, this court based its decision on Case v. Los Angeles Lumber Co., declaring it

"directly applicable to the facts . . . for it was there held that any plan which required a secured creditor to share his inadequate security with an insolvent debtor was unfair and inequitable within the meaning of the Bankruptcy Act, sec. 77B, subd. f, 11 USC 207, subd. f."

(In Case v. Los Angeles Lumber Co., the plan cut down the bondholders' lien and their participation in the debtor's assets from

$3,800,000 to $641,375,—77 per cent of the value of the security, and allocated the remaining 23 per cent of the security to the debtor's stockholders.)

The present plan differs from all such plans, in that it does not propose that the secured creditor share an inadequate security with the debtor. It grants appellee preference as to its entire demand, except over new money spent in adding value to the security; and also provides for the early liquidation of the appellee's demand.

The Act expressly authorizes that new money be given an absolute preference, sec. 116(2), 11 USC 516(2), Prima Co., 7 Cir., 88 F. 2d 785.

In this connection, Long Island Properties, 2 Cir., 125 F. 2d 206, published since the oral argument, is worth noting. The dispute before the Court of Appeals concerned a contract to complete a building program; but it appeared that the district court had previously authorized the issuance of $76,000 of first lien certificates to finance the building program. Thus in that proceeding, what is here proposed, was in fact authorized.

In none of the prior reported decisions of this court holding against proposed reorganizations, have proposals to invest new money in profitable enterprises been involved.

In Case v. Los Angeles Lumber Co., 308 U.S. at page 121, the Supreme Court declared:

"Where * * * the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made."

This case is distinguished from the Chapman Bros. case by two other crucial circumstances, to which this court has not referred in its opinion. The first is the provision in the plan (Rec. pp. 67 to 69) that the proposed dwellings be built progressively *and sold as completed*, with but six under way and unsold at a time, and that *the debtor's entire share of the proceeds* of such sales, over and above specified operating costs reasonable in amount, be applied at once to the retirement of appellee's demand *until paid in full*. The second is the unchallenged testimony (Rec. pp. 96 and 97) that the proposed sales will net the appellant about $2,000 per lot,—about $46,000 for the 23 lots,—an amount considerably in excess of appellee's gross demand.

These matters are important, not only as distinguishing this case from Chapman Bros. case, but in view of the declaration of the Supreme Court in Consol. Rock Products v. DuBois, 312 U.S. 510, at page 525:

"Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization",

a holding followed by this court in the Western Pacific Railroad case, 124 F. 2d, at page 138. (Such findings were not made in this case.)

The words of the Supreme Court in Case v. Los Angeles Lumber Co., 308 U.S. at pages 131 and 132, are directly applicable to the present case:

"There has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act

can not be adopted nor that all reasonable time for proposal of such alternative plans has expired."

It is respectfully represented that rehearing of the present case should be granted, and this court's decision modified in the light of this petition.

I hereby certify that in my judgment this petition is well founded, and not interposed for delay.

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Attorney for petitioner.